

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: MIDAMERICAN ENERGY COMPANY	DOCKET NO. EPB-02-156
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PROPOSED DECISION AND ORDER

(Issued March 19, 2003)

APPEARANCES

MS. MARGARET A. ROY, 666 Grand Avenue, P.O. Box 657, Des Moines, Iowa 50303-0657 and MS. SUZAN STEWART, 401 Douglas Street, P.O. Box 778, Sioux City, Iowa 51102, attorneys at law, appearing on behalf of MidAmerican Energy Company.

MR. BEN STEAD, attorney at law, 310 Maple Street, Des Moines, Iowa 50319, appearing on behalf of the Iowa Department of Justice, Office of Consumer Advocate.

MS. ANNE M. PREZIOSI, attorney at law, 7900 Hickman Road, Suite 1, Urbandale, Iowa 50322, appearing on behalf of the Iowa Department of Natural Resources.

MS. JENNIFER S. MOORE and MR. KENT M. RAGSDALE, attorneys at law, 200 First Street SE, P.O. Box 351, Cedar Rapids, Iowa 52406-0351, appearing on behalf of Interstate Power and Light Company.

STATEMENT OF THE CASE

On April 1, 2002, MidAmerican Energy Company (MidAmerican) filed with the Utilities Board (Board) its multiyear emissions plan and budget (EPB) for managing regulated emissions from its coal-fueled electric power generating facilities located in Iowa pursuant to Iowa Code Supp. § 476.6(25) (2001). The EPB covered the time period 2002 through 2010. MidAmerican also filed testimony in support of the EPB,

and an application requesting approval of it. In the application, MidAmerican also requested the Board to determine that expenditures made in accordance with the plan may be recovered in MidAmerican's regulated retail rates, that the expenses be reflected in MidAmerican's base rate revenue requirement until the conclusion of the RPU-01-3/5 Settlement Agreement and thereafter recovered through a subsection 476.6(11) automatic adjustment mechanism (tracker mechanism), that MidAmerican file an annual reconciliation of actual and planned costs for the prior year by February 15th of each year, that if actual annual costs are not more than 110 percent of the planned amount, MidAmerican would not have to demonstrate reasonableness of the variance unless ordered to do so by the Board, that if actual costs exceeded 110 percent, MidAmerican would file a plan update demonstrating the reasonableness of the amount exceeding 110 percent, and that if MidAmerican could achieve the same level of emissions reductions using the same or a different control method at a cost that is equal to or lower than the total cost reflected in the plan, it would not be required to make any further demonstration of reasonableness unless ordered by the Board. MidAmerican also proposed that until December 31, 2005, the costs of preparing, filing, litigating and implementing its approved plan be treated as expenses subject to the provisions of the RPU-01-03/5 Settlement Agreement, and be reflected in annual revenue sharing calculations similar to other expenditures, with an annual reconciliation to be filed. MidAmerican stated it would file the tracker mechanism tariff with a future environmental plan that would be effective for costs incurred after December 31, 2005. MidAmerican requested the Board to state in this

decision that if MidAmerican incurred the expenditures in the amounts and at the times called for in the plan, they would be considered reasonable expenditures in accordance with subsection 476.6(25)(e), and subject to recovery via the cost recovery mechanisms approved by the Board in this proceeding.

Iowa Code Supp. § 476.6(25)(a)(3) provides that an investor-owned utility's EPB shall be considered in a contested case proceeding pursuant to Iowa Code Chapter 17A. The statute further provides that the Environmental Protection Division of the Department of Natural Resources (DNR) and the Consumer Advocate Division of the Department of Justice (Consumer Advocate) shall participate as parties to the proceeding.

The Consumer Advocate filed an Answer on April 11, 2002. The Board docketed the proceeding as a formal contested case and established a procedural schedule for filing testimony in an order issued April 26, 2002.

When MidAmerican originally filed its EPB and associated testimony, it requested that almost all of the filing be treated as confidential. On April 29, 2002, MidAmerican filed an amendment to its application for a confidential order and a revised public version of its EPB and associated testimony, placing more of the filing in the public domain, although a substantial part of the EPB and associated testimony remains confidential.

The DNR filed an appearance on May 9, 2002.

On May 9, 2002, MidAmerican filed a clarification of its application for approval of the EPB. In the clarification, MidAmerican stated that it was requesting the Board

to approve its EPB "for the 24-month period which began on April 1, 2002, taking into consideration that certain costs incurred during this period are part of a series of investments extending over a longer period of time."

Interstate Power and Light Company (IPL) filed a petition to intervene on May 22, 2002, which was granted by Board order issued June 7, 2002.

On June 17, 2002, the Board issued an order assigning the case to the undersigned administrative law judge. The Consumer Advocate and DNR filed testimony and exhibits on June 21, 2002. MidAmerican filed rebuttal testimony on July 19, 2002. The DNR filed affidavits and an amendment to Ms. Fitzsimmon's testimony on July 23, 2002.

Iowa Code Supp. § 476.6(25)(d) provides that the Board shall issue an order approving or rejecting an EPB within one hundred eighty days after the utility's filing is deemed complete. An order requiring additional information was issued August 27, 2002. In the order, the term "complete" was interpreted to mean "complete" with respect to those types of emissions with associated compliance expenses that the utility included in its EPB. The term "complete" was also interpreted in a functional way. "Completeness" was interpreted to mean that the EPB must include sufficient information for DNR to perform its statutory duties under paragraph 476.6(25)(a)(4), and for the Board to be able to evaluate the EPB and determine whether it meets the statutory requirements in paragraph 476.6(25). "Completeness" was also interpreted to relate only to the information in the EPB for the two-year time period beginning April 1, 2002. The order also interpreted the term

"facilities" in the second sentence of paragraph 476.6(25)(a) to mean only coal-fired electric generation facilities. Given these interpretations, the August 27, 2002, order found the EPB was not complete, and MidAmerican was ordered to provide additional information and answers to questions. MidAmerican filed additional information with confidential attachments on September 24, 2002.

On October 10, 2002, an order was issued deeming the EPB complete, setting a procedural schedule, and establishing a hearing date. MidAmerican was directed to answer certain questions in prepared testimony. MidAmerican filed its testimony with attachments October 30, 2002, the Consumer Advocate filed rebuttal testimony on November 20, 2002, and MidAmerican filed surrebuttal testimony on December 4, 2002.

The hearing in this case was held beginning at 9:30 a.m. on December 11, 2002, in the Board hearing room, 350 Maple Street, Des Moines, Iowa. All parties except IPL were present at the hearing. Mr. Steven C. Guyer, Mr. Peter R. Hamlin, Mr. William R. Whitney, Mr. William DePriest, Mr. Gregory C. Schaefer, and Mr. Dean Crist¹, testified on behalf of MidAmerican. The undersigned requested additional information, and MidAmerican agreed to file it on January 3, 2003. The other parties were given the opportunity to object or request cross-examination regarding the new information by January 10, 2003. Mr. Charles Fuhrman testified on behalf of the

¹ Mr. Dean Crist adopted the prefiled testimony of Mr. Jack Alexander at the hearing. (Tr. 6, 197)

Consumer Advocate. Ms. Catharine Raffensperger Fitzsimmons and Mr. David Phelps testified on behalf of DNR. At the hearing, the undersigned took official notice of the part of the record in IPL's EPB case, Docket No. EPB-02-150, containing the testimony and cross-examination of Mr. Dana Maas regarding the Ottumwa plant, page four of confidential Exhibit 6, which was attached to Mr. Maas' testimony, and the information in late-filed Exhibit 9 regarding the Ottumwa plant. In addition, at the request of DNR, the undersigned took official notice of DNR Exhibit 202 that was filed in Docket No. EPB-02-150. Pursuant to an order issued January 15, 2003, the undersigned also took official notice of the part of the additional information filed by Interstate Power in Docket No. EPB-02-150 on January 15, 2003, that is related to the Ottumwa plant.

MidAmerican filed Late-Filed Exhibits 1, 2, and 3 on January 3, 2003. The other parties did not object to or request cross-examination of the additional information. MidAmerican also filed a revised version of Confidential Exhibit 5-3 on January 24, 2003.

MidAmerican and the Consumer Advocate filed initial briefs on January 31, 2003. IPL filed a statement in lieu of an initial brief on January 31, 2003, and requested that the undersigned take administrative notice of IPL's responses to questions in its initial brief in Docket No. EPB-02-150, and incorporate the responses into this docket. No party objected to this request and it is granted. MidAmerican filed a motion to reopen the record for the limited purpose of receiving an attached U.S. Environmental Protection Agency report on January 31, 2003. The other parties

did not object to the motion and it was granted in an order issued February 6, 2003. MidAmerican, the Consumer Advocate, and DNR filed reply briefs on February 10, 2003. On February 17, 2003, MidAmerican filed a motion to strike DNR's reply brief, or in the alternative, to allow the parties other than DNR to file supplemental briefs addressing only the issues raised in DNR's reply brief. The motion to strike was denied and the motion to file supplemental briefs was granted in an order issued February 18, 2003. MidAmerican filed a supplemental reply brief on February 24, 2003.

DISCUSSION OF THE EVIDENCE AND ANALYSIS

I. DNR Statutory Obligations and Plan Compliance with Current Requirements.

According to Iowa Code Supp. § 476.6(25)(a)(4), DNR must state whether the EPB meets applicable state environmental requirements for regulated emissions, and if it does not, must recommend amendments to the EPB that outline actions necessary to bring it into compliance with environmental requirements. The Board may not approve an EPB that does not meet applicable state environmental requirements and federal ambient air quality standards² for regulated emissions from

² The difference between paragraph 476.6(25)(a)(4), which requires the DNR to state whether or not the plan meets applicable state environmental requirements for regulated emissions, and paragraph 476.6(25)(b), in which the board shall not approve a plan that does not meet applicable state environmental requirements and federal ambient air quality standards for regulated emissions, is not significant, because DNR has been delegated responsibility for implementing a program sufficient to protect against a violation of the federal ambient air quality standards, and has incorporated those standards into its State Implementation Plan (SIP). (Tr. 247-248, 252-255) In effect, for the purposes of interpreting section 476.6(25), the federal ambient air quality standards are applicable state environmental requirements.

electric power generating facilities located in Iowa. Iowa Code Supp. § 476.6(25)(b).

On behalf of DNR, Ms. Fitzsimmons and Mr. Phelps testified that, to their knowledge, there are no areas of noncompliance at any of the plants at issue in this case that should have been addressed in the EPB. (Tr. 270, 284). Ms. Fitzsimmons further testified that the EPB meets applicable state environmental requirements for regulated emissions. (Tr. 270). MidAmerican presented evidence that it is in compliance with current environmental requirements. (Additional Information filed September 24, 2002, p. 4; EPB pp. 2, 8, 12-14; Tr. 40, 43; MidAmerican Exhibit 1). There is no evidence in the record to the contrary. Therefore, it is reasonable to find that the plan meets applicable state environmental requirements and federal ambient air quality standards for regulated emissions from the coal-fired electric generating facilities at issue in this case.

II. Whether approval of EPB activities and budgeted amounts that are not required by state or federal environmental law conforms to the language and intent of Iowa Code Supp. § 476.6(25).

Iowa Code Supp. § 476.6(25)(c) states that the Board shall review the EPB, and shall approve it "if the plan or update and the associated budget are reasonably expected to achieve cost-effective compliance with applicable state environmental requirements and federal ambient air quality standards" (emphasis added). In its EPB, MidAmerican is not asking for approval for a plan and budget to meet currently applicable environmental requirements. (EPB pp. 29-33; Additional Information filed September 24, 2002, pp. 2-7; MidAmerican Exhibit 1). There is no current state or federal environmental law that requires any of the actions proposed in the EPB.

(Tr. 70; EPB pp. 29-33; Additional Information filed Sept. 24, 2002, pp. 2-7). In the EPB, MidAmerican proposes to take actions to reduce emissions that it expects will be required in the future. (Tr. 25-29, 33-35, 37, 41-48, 57, 61-63, 70-71, 99, 119-120, 201, 256-263; EPB pp. 1, 3, 14-20, 27-33, 41-42; Additional Information filed Sept. 24, 2002, pp. 2-7; MidAmerican Exhibit 1).

In paragraph 476.6(25)(a), the statute says that "it is the intent of the general assembly that the state, through a collaborative³ effort involving state agencies and affected generation owners, provide for compatible statewide environmental and electric energy policies with respect to regulated emissions from rate-regulated electric power generating facilities in the state that are fueled by coal" (emphasis added). The purpose of the actions proposed in the EPB is to reduce nitrogen oxides (NOx), sulfur dioxide (SO₂), and mercury emissions. (EPB, pp. 14-20, 27-33, 41-48; Additional Information filed September 24, 2002, pp. 2-3; Tr. 63-67). Although these emissions are currently regulated, they are not regulated at the levels targeted in the EPB. MidAmerican's coal-fired plants in Iowa are already in compliance with current emission requirements. Therefore, it is questionable whether the emissions at the

³ Although the statute uses the term "collaborative effort," and MidAmerican refers to a "collaborative process" in its brief, it is doubtful whether the process established in paragraph 476.6(25)(a) is a collaborative process. To collaborate means "to work, one with another; cooperate, as on a literary work." Random House Dictionary of the English Language, Second Edition, Unabridged (1987). Since the EPB is required to be considered in a 17A contested case, ex parte rules apply, and the Utilities Board is prohibited from communicating with the parties regarding the merits of the case outside of the normal hearing process. The Board clearly could not work together with DNR, the Consumer Advocate, MidAmerican, and any intervenors as suggested in paragraph 476.6(25)(a). The statute is collaborative only in the sense that DNR, as a party to the case, states whether the plan meets applicable state environmental requirements and provides expert opinion regarding the plan, and the Board relies on DNR's statement and expertise in making its decision.

levels MidAmerican proposes to reduce them are regulated emissions within the meaning of paragraph 476.6(25)(a).

Similarly, as discussed above, paragraphs 476.6(25)(a)(4), 476.6(25)(b), and 476.6(25)(c) refer to "applicable" state environmental requirements and federal ambient air quality standards. The language of the statute clearly contemplates that utilities will address currently regulated emissions and currently applicable requirements in their EPBs. Although MidAmerican could have included a plan and budget for compliance with currently applicable requirements in its EPB, it did not do so.

There is only one paragraph in the statute suggesting the legislature contemplated that utilities may choose to include actions in an EPB that are not currently required. Iowa Code Supp. § 476.6(25)(f) states that it is the intent of the general assembly that the Board "may limit investments or expenditures that are proposed to be undertaken prior to the time that the environmental benefit to be produced by the investment or expenditure would be required by state or federal law." Clearly, the Board could refuse to approve all of the proposed expenditures contained in the EPB, or could limit them, because they are not required by currently applicable state or federal environmental law. However, the Board is not required to do so, because paragraph 476.5(25)(f) is permissive, not mandatory. Therefore, approval of proposed actions and expenditures prior to the time they are required is not necessarily incompatible with the language of the statute. The utilities and the Consumer Advocate supported this position, and DNR did not oppose it.

(MidAmerican Initial Brief, pp. 3-4, 17-19; Consumer Advocate Initial Brief, pp. 7-9; Interstate Power Initial Brief (EPB-02-150), pp. 7-12).

The purpose of the statute is to provide advance assurance to utilities that they will be able to include approved reasonable EPB costs in their regulated retail rates. Iowa Code Supp. § 476.6(25)(c) and (e). (MidAmerican Initial Brief pp. 3-4, 16-17; MidAmerican Reply Brief pp. 1, 3-5, 8-9). The statute does not impose additional environmental requirements. Given the purpose of the statute, it does not appear that approval of proposed budgetary amounts prior to the time they are required would necessarily violate the intent of the statute. The utilities supported this position, and DNR did not oppose it. (MidAmerican Initial Brief, pp. 3-4, 17-19; Interstate Power Initial Brief (EPB-02-150), pp. 7-12). The Consumer Advocate agreed that the Board should not limit investments and expenditures proposed by MidAmerican for the two-year period ending April 1, 2004, and that approval would be consistent with Iowa Code Supp. § 476.6(25). (Tr. 229; Consumer Advocate Initial Brief, pp. 7-9).

III. Whether MidAmerican's proposed emissions plan and budget should be approved.

The statute provides no explicit criteria or guidance as to whether or when the Board should limit proposed expenditures pursuant to paragraph 476.6(25)(f). However, the statute contains such criteria to be used by the Board when it evaluates a plan and budget with respect to currently applicable environmental requirements. It is reasonable to use this language as guidance when evaluating proposed activities

and expenditures that will be undertaken prior to the time they are required. The utilities and the Consumer Advocate supported this position, and DNR did not oppose it. (MidAmerican Initial Brief, pp. 5-7, 17-19; Consumer Advocate Initial Brief, pp. 7-9; Interstate Power Initial Brief (EPB-02-150), pp. 5-12). The Consumer Advocate stated the Board should limit proposed investments and expenditures under the paragraph when they are unnecessary, may become obsolete, are excessive in volume or cost, or for similar reasons. (Consumer Advocate Initial Brief, pp. 7-8).

Paragraph 476.6(25)(c) provides that the Board shall approve the plan and budget if they are "reasonably expected to achieve cost-effective compliance" with applicable requirements. "In reaching its decision, the board shall consider whether the plan or update and the associated budget reasonably balance costs, environmental requirements, economic development potential, and the reliability of the electric generation and transmission system." Iowa Code Supp. § 476.6(25)(c). Iowa Code Supp. § 476.6(25)(e) provides that the "reasonable costs" incurred for preparing, filing, and participating in Board proceedings, and the "reasonable costs" of implementing the plan shall be included in regulated retail rates. Paragraph 476.6(25)(e) provides further support that the budget is to be reviewed for reasonableness under paragraph 476.6(25)(c). The EPB will be evaluated using these criteria. MidAmerican must present sufficient evidence to prove its EPB meets the criteria contained in the statute.

When discussing whether the EPB should be approved, the parties relied heavily on their belief that future environmental requirements applicable to coal-fired power plants in Iowa will be increasingly stringent and will require significant additional reductions of certain emissions. (EPB, pp. 1, 14-20, 27-32, 42, Appendix II, pp. 3-7; Tr. pp. 25-29, 33-35, 37, 41-43, 57, 61-63, 70-71, 99, 119-120, 201, 256-263, 269; Additional Information filed September 24, 2002, pp. 2-6; MidAmerican Initial Brief pp. 5, 19; Interstate Power Initial Brief (EPB-02-150) pp. 6, 9, 12; Consumer Advocate Initial Brief p. 8). DNR agreed with this belief, and DNR witness Ms. Fitzsimmons testified she agreed with the position that "there will likely be significant modification to the Clean Air Act as it relates to regulation of mercury, SO₂, and NO_x. Continuing air quality problems in certain cities and in the east and southeast will compel additional air emission regulation of coal-fired power plants." (Tr. 256). She also testified regarding various prospective changes to environmental requirements that may require MidAmerican's Iowa plants to reduce emissions. (Tr. 257-266; DNR Exhibit 2, Schedule B). Witness Ms. Fitzsimmons further testified that it is reasonable to assume that the trend of increasingly stringent environmental requirements applicable to coal-fired power plants will continue, and that it is reasonable to assume that additional reductions of regulated emissions will be required from coal-fired generating plants in Iowa. (Tr. 269). There is no evidence to the contrary in the record. However, the levels of reductions that will be required are not known, and the times for required compliance are not known. (EPB, pp. 14-20, 27-28; Tr. 25-29, 33-35, 37, 43, 61-63, 202, 256-259, 261-263; Additional Information

filed Sept. 24, 2002, pp. 4-5). MidAmerican witness Mr. Guyer testified that when compared to current emissions, emissions caps proposed in President Bush's Clear Skies Initiative for power generation sources represent the equivalent of a 60 percent reduction in sulfur dioxide (SO₂) by 2010 and 73 percent by 2018, a 58 percent reduction in nitrogen oxides (NO_x) by 2008 and 67 percent by 2018, and a 46 percent reduction in mercury by 2010 and 69 percent by 2018. (Tr. 25). He testified that, "At this time, MidAmerican believes these reductions are likely to represent a floor as Congress debates multi-pollutant legislation." (Tr. 25). MidAmerican presented evidence regarding projected reductions of several pollutants it expects will be required from its Iowa generating plants, and its resulting emissions reductions targets⁴. (EBP pp. 14-20, 28-31, 43-48, Appendix II, pp. 1-7, 25-49, Exhibits 4-23 to 4-32, 51-54, Exhibits 5-1 to 5-7; Tr. 61-63, 65-67, 95-99, 120; Additional Information filed September 24, 2002, p. 5).

Based on the record, as of the date of this proposed decision, it is reasonable to assume that significant additional air emission reductions will be required from the plants at issue in this case in the future. This is a record-specific and date-specific finding that will be re-evaluated with each EPB and update filed with the Board in which MidAmerican proposes actions and expenditures not required by currently applicable environmental law. Therefore, in evaluating the reasonableness and cost-

⁴ MidAmerican filed most of the information containing its predictions of required emissions reductions confidential pursuant to 199 IAC 1.9, so this order cannot include details of the predictions even when the record contains such information.

effectiveness of the proposed actions and budget, and when considering whether the plan and budget reasonably balance the factors listed in paragraph 476.6(25)(c), the undersigned will assume that there will be increasingly stringent environmental requirements for regulated air emissions from the plants at issue in this case, and that reductions of emissions in the range of the levels and during the timeframes discussed in the EPB and in MidAmerican testimony will be required.

In its EPB, MidAmerican proposed a phased-in approach to reduce emissions at some of its Iowa plants over the years 2003-2010. (EPB pp. 31-48; MidAmerican Exhibit 1). However, on May 9, 2002, MidAmerican clarified that it is requesting approval of the activities proposed in its plan and the associated budget only for the two-year period ending March 31, 2004, "taking into consideration that certain costs incurred during this period are part of a series of investments extending over a longer period of time." (Clarification of Application; Tr. 111-12)

In the two-year period ending March 31, 2004, MidAmerican proposes to install neural networks at most of its Iowa coal-fired plants. (Tr. 64-65, EPB pp. 42, 44-48; EPB Tables 4 and 5 (revised); MidAmerican Exhibit 1; Additional Information filed Sept. 24, 2002, pp. 2-4, 6, 10-12; Consumer Advocate Exhibit 101; Late-filed Exhibit 1). MidAmerican and IPL are joint owners of the Ottumwa generating plant, and IPL operates the plant. (EPB p. 42; Tr. 63; Additional Information filed September 24, 2002, pp. 10, 12). In this EPB, MidAmerican also included certain activities and equipment to be implemented by IPL at the Ottumwa plant. (EPB pp. 42, 48, 51-52; Additional Information filed September 24, 2002, pp. 10, 12,

Attachments 1 and 3; Tr. 63; Attachment 1 filed October 30, 2002; Late-filed Exhibit 1). In this EPB, MidAmerican requests approval only for the installation of the neural networks and the work to be done by IPL at the Ottumwa plant, and for the associated budgets. (Clarification of Application; Additional Information filed September 24, 2002, pp. 10-12; Late-filed Exhibit 1).

The proposed activities and budget for the Ottumwa plant were approved in In re: Interstate Power and Light Company, Docket No. EPB-02-150. Since MidAmerican requests approval of the identical activities and budget in this case, they are therefore approved for the same reasons given in the decision in Docket No. EPB-02-150.

A neural network is a system of computer hardware and software, sensors, and monitors tied into the plant's control system. (EPB p. 41, Appendix II p. 24; Tr. 37, 65, 68; Late-filed Exhibit 1). Neural networks are online enhancements to a digital control system and plant information system targeted at improving boiler performance parameters such as heat rate, NOx emissions, carbon monoxide (CO) levels, and fly ash carbon levels. (EPB p. 41, Appendix II, p. 24). The neural network software applies an optimizing procedure to identify the best set points for the boiler. (EPB p. 41, Appendix II, p. 24, Tr. 65-68). These set points are implemented either automatically or by the plant operator. (Id.) The neural networks are designed to adapt to plant changes, including the installation of emissions control equipment. (Id.) They improve plant efficiencies, so the plant burns less coal for

every megawatt-hour of energy generated, as well as reducing NO_x, SO₂, mercury, and CO₂ emission rates. (Additional Information filed September 24, 2002, pp. 2-4).

DNR witness Ms. Fitzsimmons testified that if MidAmerican installs the neural networks as proposed in the EPB, they likely will result in emission reductions as MidAmerican outlined. (Tr. 270). Mr. Phelps testified that DNR has not received air construction permit applications from MidAmerican for any of the modifications proposed in the EPB. (Tr. 275-276). He further testified that construction permits are not required for the modifications because they will reduce emissions. (Tr. 276). However, he also testified that if MidAmerican chooses to make physical changes to its operations that affect air emissions to the outside atmosphere, and claims they are exempt from permitting because they will reduce emissions, MidAmerican must provide required information to DNR so DNR can determine that MidAmerican's claim is correct. (Tr. 277; DNR Exhibit 1, Schedule B). MidAmerican has not yet provided this information to DNR. (Tr. 277).

Witness Phelps testified the various proposed modifications in the EPB will have the ability to reduce emissions of the stated pollutants⁴. (Tr. 278) He further testified that it is not known at this time whether the reductions mentioned in the plan will be sufficient to meet future regulations, as those requirements are not known. (Tr. 278).

⁴ Mr. Phelps was referring to all the modifications proposed through 2010, and did not specifically discuss the effect of the neural networks.

In response to a MidAmerican data request, DNR stated that the neural networks likely will not be sufficient to meet future final requirements, but will help to assure continuing compliance with current requirements, and move MidAmerican toward compliance with potential future emissions reductions requirements. (MidAmerican Exhibit 1). In the answer to the data request, DNR further expressed the opinion that MidAmerican's "phased approach to meeting new regulations not yet promulgated is reasonable to the extent that the actual dates for compliance with new regulations prove consistent with MidAmerican's estimate of when those reductions will be required." (MidAmerican Exhibit 1).

MidAmerican proposes a phased approach, with the first phase consisting of installation of neural networks and modifications to the Ottumwa plant, prior to the time the changes are required by applicable state and federal environmental law for several reasons. As discussed above, MidAmerican believes that significant additional air emission reductions will be required from its coal-fueled plants by the year 2010, although emission standards and required times to meet the new standards are unknown. MidAmerican stated that to cost-effectively manage compliance with future regulations, it cannot wait until the last minute to install required emission control equipment. (Additional information filed September 24, 2002, p. 2, Tr. 55-57). Installation of emissions control equipment requires significant labor and time to plan and implement. (Id.) A phased approach ensures there will be no unnecessary expenditures and that air quality standards will be met. (Tr. 37).

MidAmerican witness Mr. Whitney testified MidAmerican's plan attempts to put control technologies in place close to the projected required date. (Tr. 49). To ensure adequate energy supply to meet customers' needs, MidAmerican considered plant outages required for installation of control equipment, because not every plant can be off-line simultaneously. (EPB, pp. 49-50; Tr. 49, 55-57; Additional Information filed September 24, 2002, p. 2). By staggering outages, MidAmerican will minimize negative impacts on the transmission and generation system, because some generating plants in each area will be available at all times to support the transmission system. (EPB, pp. 49-50; Tr. 51-52; Additional Information filed September 24, 2002, p. 2). In addition, MidAmerican plans to install the equipment during each plant's scheduled maintenance outage, thus eliminating the need for additional outages. (Tr. 52, 55-57; Additional Information filed September 24, 2002, p. 2). Witness Mr. Whitney testified that the neural networks can be tied into the plants' control systems while they are operating, so outages will not be required for installation of the neural networks. (Tr. 65). MidAmerican also factored in competition for the labor pool to do the work and demands on equipment suppliers, since MidAmerican expects many utilities will make similar upgrades by future deadlines. (Tr. 49; Additional Information filed September 24, 2002, p. 2).

Witness Mr. Whitney testified that MidAmerican's capacity plan includes the most recent expectations of impacts resulting from compliance with new environmental requirements, and the capacity plan will be updated as the environmental plan changes. (Tr. 51). He also testified that capacity impacts

resulting from environmental compliance are small in relation to MidAmerican's overall portfolio and customer requirements. (Tr. 51). He testified that MidAmerican's EPB anticipates the time needed to purchase equipment and materials, hire labor, make alterations, and install control equipment, and is designed to make the changes while serving customers fully. (Tr. 51).

MidAmerican stated that the phased approach and installation of the lower-cost neural networks as the first step in its EPB is appropriate given what is known today. (Tr. 37, 49, 64-68, 202; Additional Information filed September 24, 2002, pp. 2-4, 6). Installation of the neural networks will allow MidAmerican to establish an emission baseline from which to develop future plans. (Additional Information filed September 24, 2002, p. 2). MidAmerican recently installed a neural network at the Council Bluffs Unit #3 plant and NOx reductions greater than anticipated were obtained. (Additional Information filed September 24, 2002, p. 2). MidAmerican further stated that even the most lenient proposals for future requirements will require NOx reductions greater than those that can be achieved with the neural networks. (Additional Information filed September 24, 2002, p. 2-3). It stated that if a lower baseline can be developed from the neural networks, future installation of the most expensive types of control technologies may be avoided. (Additional Information filed September 24, 2002, p. 3).

MidAmerican stated that the addition of emissions controls will have positive effects on economic development. (EPB, p. 49; Tr. 52). Significant construction on generating plants to add emissions controls will bring workers, jobs, and money to

the communities, and some permanent plant jobs will be created to support the new environmental control equipment. (EPB, p. 49; Tr. 52). Reducing emissions of generating plants may make permitting of new industrial facilities near the plants easier. (EPB, p. 49; Tr. 32-33, 52). MidAmerican stated its rates are competitive, and it does not expect that to change as a result of the changes described in the EPB. (Tr. 53).

MidAmerican stated there are environmental benefits to Iowa citizens when emissions are reduced, and the sooner emissions are reduced, the sooner benefits will accrue. (MidAmerican Initial Brief, pp. 17-18; EPA report; Additional Information filed September 24, 2002, p. 3). It stated these benefits represent public policy reasons to approve emissions reduction expenditures prior to the time the reductions are mandated by state or federal law. (MidAmerican Initial Brief, pp. 17-18).

Assuming the parties are correct that significantly more stringent environmental requirements, including significant SO₂, NO_x, and mercury emissions reductions will be required of the generating plants at issue in this case, MidAmerican has presented sufficient, uncontroverted evidence to support a finding that its phased approach and the installation of neural networks proposed in the EPB are reasonable. This finding relates only to the activities proposed for the two-year period ending March 31, 2004. In its Initial Brief, MidAmerican stated the Board should consider how the two-year plan fits into the longer 9-year series of investments, and that although MidAmerican is only seeking approval of the first two years, it is important to review the remainder of the plan to understand its series of

investments. (MidAmerican Initial Brief, pp. 4, 6-7). In its Reply Brief, MidAmerican stated that "In its Initial Brief at page 8, Consumer Advocate contends that it obtained MidAmerican's "agreement" to limit its request for budget approval for a two-year period, only. This statement somewhat misinterprets MidAmerican's intent in filing a 9-year program of investments with the Board. MidAmerican clarified its Application to the Board for approval in this docket, asking the Board to consider that the two-year period of investments for which approval was sought was part of a more extended series of investments. MidAmerican has not "agreed" that the Board should ignore the remainder of its emission control investments." (Emphasis in original) (Reply Brief, p. 1, f/n 1). However, testimony at the hearing was clear that MidAmerican is not requesting approval of any plans or expenses beyond March 31, 2004. (Tr. 112). In the order issued August 27, 2002, the undersigned ruled that "completeness" pursuant to paragraph 476.6(25)(d) meant the plan and budget must include sufficient information for DNR and the Board to be able to perform their required functions, and that "completeness" related only to the information in the plan and budget for the two-year period beginning April 1, 2002. MidAmerican's EPB is incomplete with respect to actions and budget items beyond the two-year period. In addition, MidAmerican may make significant modifications to its next plan or update, and circumstances regarding environmental requirements may change considerably in the next two years. Therefore, no evaluation of the activities proposed beyond this two-year period has been made, and approval of the neural networks and initial work

at the Ottumwa plant does not indicate that approval beyond the two-year period will or will not be granted.

In its Initial Brief at page seven, MidAmerican states that in the future, it expects to seek advance approval when an investment spans three years of expenditures, and it would be disadvantageous and contrary to the concept of certainty of investment for MidAmerican to receive approval for the first two years of expenditures, but have an integral part of expenditures on the same project disapproved for year three. There is nothing in the statute that would prevent MidAmerican from seeking such approval.

The next step in evaluating the EPB is to determine whether the budgeted amounts are reasonably expected to achieve cost-effective compliance with applicable or reasonably anticipated future environmental requirements, reasonably balance costs with the other statutory criteria, are reasonable, and therefore should be approved in this proceeding. Iowa Code Supp. § 476.6(25)(c) and (e). If proposed budgeted amounts are not approved in this EPB case, there is nothing in the statute that would prevent MidAmerican from attempting to receive after-the-fact approval for the amounts spent in a traditional rate case, after December 31, 2005. However, if the budgeted amounts are approved in this case, it will minimize the risk for MidAmerican that expenditures for the EPB activities would not be approved in a future rate case.

MidAmerican stated that since installation of the neural networks will result in less coal burned for each megawatt-hour of energy generated, customers would

benefit from lower fuel costs under MidAmerican's current revenue sharing arrangement. (Additional Information filed September 24, 2002, p. 3). MidAmerican also stated that its plan is based on the lowest-cost approach with the emission control technologies that existed as of April 1, 2002. (Tr. 58, 122).

MidAmerican provided detailed cost information and explanations of the basis for the amounts budgeted for the neural network at each plant for the period April 1, 2002, through March 31, 2004⁵. (EPB pp. 1, 44, 48, 51-52, Appendix II, pp. 24, Exhibit 4-23, Exhibit 5-1; Additional Information filed September 24, 2002, pp. 8-14, Attachments 1 through 3; Tr. 49, 55-57, 64-66, 68-69, 100-105, 107-108, 110-112, 117-125; Attachment 2 filed October 30, 2002; Late-filed Exhibits 1 and 2). MidAmerican is requesting approval of the MidAmerican share of the 2002-2004 costs for each plant contained on revised Tables 4 and 5 in Late-filed Exhibit 1, rather than for the total amounts for each plant listed on the tables. (Tr. 108).

The proposed budget for the Ottumwa plant is approved for the reasons provided in the decision in In re: Interstate Power and Light Company, Docket No. EPB-02-150. The budget that is approved for the Ottumwa plant is that contained in Late-Filed Exhibit 9 (as amended January 15, 2003) filed in Docket No. EPB-02-150. (See Proposed Decision and Order, Docket. No. EPB-02-150).

MidAmerican hired Sargent & Lundy to evaluate its plants (other than the Ottumwa plant) and recommend emission control technologies. (Additional

⁵ MidAmerican filed almost all of the budget information as confidential, pursuant to 199 IAC 1.9, so this order cannot include specific budgeted amounts even when the record contains such information.

Information filed September 24, 2002, pp. 7-8; Tr. 117-125). Sargent & Lundy is experienced in helping utilities comply with emissions requirements, and maintains a database of control technologies and their costs, power consumption, efficiency impacts, and emission reductions. (Id.) Sargent & Lundy provided the estimates for the costs of the neural networks to MidAmerican, which were based on Sargent & Lundy's database. (Id.) The neural network estimates in the database are based on prior experience with similar customers, information from suppliers, and information in technical papers. (Tr. 124)

MidAmerican installed a neural network at Council Bluffs Unit #3 in 2002, and the budgeted costs for that plant are based on actual expenditures. (Tr. 66; Late-filed Exhibit 1). In 2002, MidAmerican received proposals for neural network installations at its plants from potential vendors, and the revised budget estimates are based on these estimates and the Council Bluffs Unit #3 experience. (Tr. 64-65; Late-filed Exhibits 1 and 2). The estimates include capital and operations and maintenance expenses, including installation. (Late-filed Exhibit 1).

Evidence in the record submitted by IPL in this docket and in Docket No. EPB-02-150 showed that some items proposed for the Ottumwa plant were not yet commercially available, and the parties in both cases were asked to brief the question of whether the Board should approve budget amounts for the items not yet commercially available. On January 15, 2003, in Docket No. EPB-02-150, IPL filed evidence that clarified all items it proposes to install are now commercially available, although several listed items are not currently available in the form or up to the

standards that IPL requires, that IPL is confident the items would meet standards in the two-year period, and that IPL would not install equipment that is not commercially viable. Since it appears the items are commercially available and will likely meet IPL standards within the two-year period of this EPB, the decision in Docket No.

EPB-02-150 found that the budgets for these items would be treated the same as the rest of the budgeted items. In its Initial Brief, MidAmerican asked that the issue be considered in general, rather than being specific to the Ottumwa plant, and argued the Board should review costs without regard to whether the Board believes the investment is commercially available. (MidAmerican Initial Brief, p. 24).

MidAmerican provided the example of control equipment created for a particular plant, and argued that utilities should be able to recover the cost upon a showing that the cost is reasonable. (Id.) The Consumer Advocate argued in its brief that the Board should approve items not yet commercially available that are likely to become available within the EPB time period. (Consumer Advocate Initial Brief, p. 11). Since the issue of commercial availability is no longer an issue in this case, the undersigned declines to rule on it at this time. The Board may wish to decide the issue in a general sense in a future case. Until such a decision is made, the parties may argue in future cases that a proposed expenditure for an item not yet commercially available is reasonable, show how the cost can be reasonably estimated, and argue that it should be approved.

The Consumer Advocate did not propose any cost disallowance for MidAmerican's proposed budget for the two-year period ending March 31, 2004. (Tr. 229).

MidAmerican has presented sufficient, uncontroverted evidence to prove the amended budgeted amounts for installation of the neural networks, contained in Late-filed Exhibit 1, for the two-year period ending March 31, 2004, are reasonably expected to assist in achieving cost-effective compliance with future environmental requirements and are reasonable. MidAmerican has presented sufficient, uncontroverted evidence to prove that the plan and associated budget are reasonably expected to assist in the achievement of cost-effective compliance with future state environmental requirements and federal ambient air quality standards that will be imposed on the Iowa plants at issue in this case within the time periods predicted by MidAmerican. It has presented sufficient, uncontroverted evidence to prove the plan and budget reasonably balance costs, environmental requirements (current and future), economic development potential, and the reliability of the electric generation and transmission system.

The emissions plan and budgeted amounts are therefore approved. Approval of the budget is not approval of a gross amount for all activities at all of the plants. Rather, for all plants other than the Ottumwa plant, it is approval of the plant-specific, activity-specific budget for the MEC share amounts contained in Late-filed Exhibit 1, for the period ending March 31, 2004, and for the Ottumwa plant, it is approval of the

amounts contained in Late-filed Exhibit 9 (as amended January 15, 2003) filed in Docket No. EPB-02-150, for the period ending March 31, 2004.

IV. Whether MidAmerican's proposal for a tracker mechanism should be approved.

MidAmerican argues that the Board should authorize automatic adjustments to rates to recover EPB costs. (MidAmerican Initial Brief, p. 11). It proposes that after December 31, 2005, it be allowed to recover approved EPB expenses through the use of an environmental tracker mechanism. (Application for Approval, pp. 3-7; MidAmerican Initial Brief, pp. 11-14, 20, 25-27; MidAmerican Reply Brief, pp. 5-8; Tr. 68, 130-139, 141-144, 146-156, 158, 161-166, 168-170, 172-194, 203-204, 213, 218). Prior to December 31, 2005, MidAmerican proposes that its EPB costs be subject to recovery just as any other costs pursuant to the terms of the Settlement Agreement approved by the Board in Docket Nos. RPU-01-3/RPU-01-5. (Tr. 135; MidAmerican Initial Brief, pp. 11-12). The costs would not be deferred for later recovery in the tracker and depreciation expenses associated with environmental capital items would also not be deferred. (Tr. 135). The annual cost associated with any rate base additions or O&M expenses associated with the EPB would be reflected in the annual revenue-sharing calculation. (Tr. 135).

MidAmerican stated it would implement the environmental tracker beginning in 2006 to recover capital and O&M costs incurred under the EPB. (Tr. 131). It would only run expenditures that it actually made through the tracker. (Tr. 158). MidAmerican would annually prepare a tariff filing reflecting the costs. (Tr. 135). The

first tariff would be filed with a future EPB and be effective for costs incurred after December 31, 2005. (Application for Approval, p. 5).

The rates reflected in the tracker would be intended to recover the following costs: 1) budgeted O&M costs, including any increased fuel costs resulting from increased heat rates associated with environmental compliance measures; 2) depreciation expenses associated with capital expenditures under the EPB; 3) a return on rate base items associated with the EPB; and 4) a reconciliation of prior years' actual recoveries under the tracker with actual costs. (Tr. 136). MidAmerican stated it would conduct heat rate tests at each plant immediately before and after the installation of environmental control equipment, and the percent change in the unit's heat rate attributable to the equipment would be recorded. (Tr. 68). The percent change would be assumed to remain constant throughout the life of the equipment. At the end of each year, MidAmerican would calculate the total fuel expense for each unit and multiply that number by the percent heat rate change (increase or decrease) recorded for the unit's combined environmental control installations. (Tr. 68). The net costs or credits from these changes would be included in the tracker. (Tr. 68). MidAmerican expects that the neural networks will increase each plant's efficiency by a given percentage. (Tr. 149, 183-84). This percentage would be applied to the cost of fuel burned at each station to determine the fuel cost savings at each plant associated with the neural network. (Tr. 149) These savings would act to reduce the total costs to be recovered via the tracker. (Tr. 149, 184-85). This method would be applied to all environmental equipment installed in the plants in the EPB. (Tr. 149).

MidAmerican proposed that the appropriate depreciation life would be the depreciation life used for the generating station where each individual capital improvement was implemented under an EPB. (Tr. 150). MidAmerican proposed a method for determining the return to be earned on rate base items and how costs would be allocated to each class of customers. (Tr. 136). For environmental additions at plants where the return has been the subject of a ratemaking principles proceeding, the return would be that approved by the board in the proceeding. (Tr. 136, 150) At other facilities, MidAmerican proposed that the return could be that established in MidAmerican's most recent rate proceeding, or in another manner approved by the Board. (Tr. 136, 150). MidAmerican proposed that EPB costs be allocated to customer classes based on the allocator most recently approved by the Board in a MidAmerican proceeding for generation costs. (Tr. 136).

MidAmerican proposes to file an annual reconciliation by February 15 of each year following approval of the EPB that shows the planned and actual costs. (Application for Approval, p. 4; Tr. 148, 162, 204, 213, 218). In its Initial Brief at page 11, MidAmerican stated the proposed tracker is an annual factor to be applied to all affected utility billings during a given calendar year.

MidAmerican requests approval of the tracker mechanism at this time, even though it would not be implemented until 2006, to provide MidAmerican with certainty about the cost recovery mechanism it would have going forward as MidAmerican plans for post-2005 environmental costs. (Tr. 139, 192-194; MidAmerican Initial Brief, p. 20; MidAmerican Reply Brief, p. 6-7). MidAmerican also states that it will

require lead time to implement a tracker mechanism on its billing system.

(MidAmerican Initial Brief, p. 20). It argues that the next scheduled plan will be filed April 1, 2004, and that if there are complicated issues the proceeding could take over a year, which would leave MidAmerican inadequate time to implement the new charge for billings beginning January 1, 2006. (Id.) It argues that the public policy and legal arguments supporting a tracker should not change significantly between now and 2004, and the time to rule on the issue is now. (MidAmerican Reply Brief, p. 7, 10).

MidAmerican argues that it is appropriate to use a tracker to recover EPB costs. (MidAmerican Initial Brief pp. 11-14, 20, 25-26; MidAmerican Reply Brief pp. 5-7). It argues that unlike other utility costs, the legislature has expressly authorized recovery of reasonable EPB costs in utility rates. (MidAmerican Initial Brief, p. 12; MidAmerican Reply Brief p. 5). It argues that a tracker is the only mechanism that would allow MidAmerican to fully recover its EPB costs, because if traditional ratemaking were used, regulatory lag would prevent full cost recovery. (MidAmerican Initial Brief, p. 12; MidAmerican Reply Brief, pp. 5-6).

MidAmerican argues that use of a tracker to recover EPB costs is permitted by Iowa Code section 476.6(11), which states that chapter 476 does not prohibit a utility from using a tracker provided that a schedule showing the adjustment of rates and charges is first filed with the Board. (MidAmerican Initial Brief, p. 13). MidAmerican argues that the Board has approved the use of a tracker for fuel cost adjustments, variable bond interest, payments made to alternative renewable energy producers,

reserve accounts for costs associated with nuclear outages, energy efficiency implementation costs, and Cooper nuclear station capital expenditures. (Tr. 136-139; MidAmerican Initial Brief p. 13). MidAmerican argues that use of a tracker to recover energy efficiency costs is the only case in which there is express statutory authorization for use of a tracker. (MidAmerican Initial Brief, p. 13).

MidAmerican further argues that EPB costs have similar characteristics to those costs that the Board has identified for recovery through automatic fuel clauses. (MidAmerican Initial Brief p. 13). It argues that the Board has indicated in rule 199 IAC 20.9(1), in the context of electric fuel adjustment clauses, the types of costs that are recoverable through a tracker method. (MidAmerican Initial Brief, p. 14).

Board rule 20.9 is a rule regarding use of a tracker for costs for fuel used to produce electricity. Board rule 20.9(1), states "A rate-regulated utility's . . . automatic adjustment of electric utility energy rates shall recover from consumers only those costs which: [a]re incurred in supplying energy; [a]re beyond direct control of management; [a]re subject to sudden important change in level; [a]re an important factor in determining the total cost to serve; and [a]re readily, precisely, and continuously segregated in the accounts of the utility."

MidAmerican argues that other tracker applications share at least some of these characteristics, but that there is no legal requirement that costs meet these characteristics in order to be recovered through a tracker. (MidAmerican Initial Brief, p. 14). It argues that EPB costs in general meet these characteristics. (Tr. 133-134; MidAmerican Initial Brief, p. 14). MidAmerican states that the equipment is installed

to produce energy, thus the costs are incurred in supplying energy. (Id.) It argues the need to control emissions arises from a governmental order, and the need to comply is therefore beyond the control of utility management. (Tr. 131, 134; MidAmerican Initial Brief, p. 14). It further argues that costs change dramatically from year to year, and in some of the later years, the costs are very significant. (Id.) Finally, it states that the costs will be separately accounted for on MidAmerican's books. (Id.)

The Consumer Advocate opposes MidAmerican's request for approval of a tracker mechanism. (Tr. 229-231, 236-239; Consumer Advocate Initial Brief, pp. 1-4, 9, 12). Furthermore, the Consumer Advocate argues that there is no purpose in approving the tracker mechanism at this time, and that it should be considered in the 2004 update. (Consumer Advocate Initial Brief, p. 9).

The Consumer Advocate argues that EPB costs should only be recovered in base electric rates established after full review in a rate proceeding, and then, only to the extent that such costs are determined by the Board to be reasonable. (Consumer Advocate Initial Brief, p. 1). The Consumer Advocate's position is that this is required by Iowa Code § 476.6(25)(e). (Id.) It argues that only a full review in a rate case can provide the Board the statutorily mandated opportunity to determine the reasonableness of the costs incurred by MidAmerican in implementing its Board-approved EPB. (Id.) The Consumer Advocate argues that EPB costs are not significantly different from other investments an electric utility makes or other expenses an electric utility incurs. (Consumer Advocate Initial Brief, p. 2). It states

that such costs have always been reviewed by the Board for reasonableness in rate proceedings, and only reasonable costs have been allowed in base rates. (Id.) It argues that emissions costs, like virtually all other costs incurred by the utility, should continue to be reviewed by the Board for reasonableness in a rate case. (Id.) It further argues that section 476.6(25) does not explicitly or implicitly contemplate the use of a tracker mechanism. (Id.) It argues this is in contrast to the energy efficiency statute, which explicitly provides for a tracker. (Consumer Advocate Initial Brief, pp. 2-3) It argues that if the legislature had intended that emissions costs were to be recovered through a tracker, it would have said so. (Consumer Advocate Initial Brief, p. 3).

The Consumer Advocate further argues that EPB costs are unlike fuel costs that are recoverable pursuant to rule 20.9(1). (Tr. 237-239; Consumer Advocate Initial Brief, p. 3). The Consumer Advocate disagrees with MidAmerican that the costs are incurred in supplying energy within the meaning of the rule. Although EPB costs are incurred in supplying energy, the investment in generating facilities into which the emissions technology will be incorporated would likewise involve costs incurred in supplying energy, and utilities are not allowed to recover either that investment or non-fuel O&M costs associated with electric generation facilities through the tracker. (Tr. 237). The Consumer Advocate argues that a distinct component of those generation facilities, the emissions control technology, does not warrant different cost-recovery treatment from the rest of the facilities of which it is a part. (Id.)

The Consumer Advocate disagrees with MidAmerican's assertion that emissions control investment and operating costs are beyond the control of management. (Id.) It argues that these costs are clearly not comparable to the volatility of fuel and purchased power costs that are influenced directly by both customer demand and market conditions. (Id.) The Consumer Advocate argues that EPB costs are largely within the direct control of management, as they can select the appropriate emissions investments, the timing of those investments, and the associated O&M cost levels. (Id.) The Consumer Advocate argues that management control over these investments is no different than the control exercised by management over investments in generation, transmission, and distribution plant in order to comply with the Iowa Code § 476.8 requirement to furnish reasonably adequate service and facilities. (Tr. 238).

The Consumer Advocate disagrees with MidAmerican's statement that EPB expenses are subject to sudden important changes in level. (Tr. 238). New emissions requirements imposed by statute or administrative rule are imposed over a long period of time. (Id.) In contrast, the Consumer Advocate argues that fuel and purchased power costs can and have fluctuated widely from month to month. (Id.) In addition, the Consumer Advocate argues that EPB budget levels selected by management are approved ahead of time by the Board in the periodic EPB filings. (Id.)

The Consumer Advocate disagrees with MidAmerican's position that EPB costs are an important factor in determining the total cost to serve. (Id.) It argues

that EPB costs are not as significant in terms of proportionate magnitude as fuel and purchased power costs, and should be compared with MidAmerican's annual electric revenue requirement. (Tr. 238-39).

Although the Consumer Advocate generally agrees that EPB costs may be readily, precisely, and continuously segregated in the accounts of the utility, it asserts that this is also true for many costs that are not subject to recovery via a tracking mechanism. (Tr. 239). It argues that EPB costs are clearly distinguishable from fuel and purchased power costs that are the kinds of costs for which a tracker mechanism is normally used to recover costs. (Tr. 239). Through cross-examination, it suggested that the Cooper tracker situation was not comparable to this case. (Tr. 179-180)

The Consumer Advocate argues that the Board has always severely limited the use of tracker mechanisms to a narrow area of utility costs, that is, fuel and energy efficiency costs. (Consumer Advocate Initial Brief p. 3). It states this is due to the difficulty, if not impossibility of assessing reasonableness of costs automatically passed through to customers, and the impairment of, or elimination of, utility incentive to operate efficiently in minimizing the magnitude of costs automatically passed through to customers. (Id.) The Consumer Advocate argues the use of this extraordinary mechanism for normal and routine emissions costs is unwarranted and poor public policy. (Consumer Advocate Initial Brief, pp. 3-4).

The undersigned administrative law judge finds that approval of a tracker mechanism to recover EPB costs would be inappropriate. First, § 476.6(25) does not

provide for the use of a tracker. Although MidAmerican is correct that the statute is unique in requiring that reasonable EPB costs be included in regulated retail rates, it does not specify that a tracker mechanism should be used. Second, although MidAmerican is correct that the Board could exercise its discretion pursuant to § 476.6(11), allowance of a tracker for recovery of EPB costs would be inconsistent with prior uses of such trackers, because the primary uses of tracker mechanisms in the past have been for recovery of energy efficiency plan costs pursuant to Iowa Code § 476.6(19)(e), and for recovery of fuel and purchased power costs pursuant to Board rule 20.9.

When implementing an energy efficiency plan, the utility does not know how many customers will participate from year to year, and has little control over the number of customers that will participate. The number of customers that participate varies, sometimes dramatically, from year to year. Similarly, fuel costs are volatile, and the utility has very little control over them. Tracker mechanisms were allowed for fuel costs because the big variation in costs made it difficult to predict what the utility's fuel costs would be, and it was a hardship for utilities to wait for rate cases to recover their costs. Utilities had to spend large amounts of money for fuel, and were financially harmed because rates had been set on the basis of fuel costs that were predicted to be much lower. Tracker mechanisms are appropriate for such recurring but volatile expenses. In addition, the nature of these expenses is that once the money is spent, the item is gone. Natural gas is burned. Money is paid to a customer for a rebate on an energy efficient furnace.

On the other hand, when the utility spends money on improvements to plant, the expenses are added to the rate base, there is an increase in the capital of the company, and customers are asked to pay for the improvements in rate increases set in a traditional rate case. Utilities may not use a tracker mechanism to recover these types of costs.

EPB expenses are not like volatile costs of fuel or energy efficiency plan costs. They are largely improvements to the plant itself, and costs of EPB improvements should be recovered in the same manner as recovery for other plant improvements.

Although rule 20.9 specifically relates to the use of a tracker for fuel and purchased power costs, the parties analyzed the factors contained in rule 20.9(1) in arguing whether a tracker should be allowed. Rule 20.9 is not a general rule that applies to all trackers, and therefore, the criteria contained in it are of limited value in analyzing whether an EPB tracker is appropriate. Having said this, since the parties argued whether the criteria were met, the undersigned finds that EPB costs do not fit within the 20.9(1) criteria.

First, EPB costs are incurred in supplying energy only in the sense that most, if not all, of the costs of generation activities of an electric utility are incurred in supplying energy. As discussed above, EPB costs are like investments in the generating facility itself, not like the costs of fuel, and thus may not be recovered through the use of a tracker any more than recovery of the costs of the generation plant could be. The proposed costs are not those incurred in supplying energy, such as the cost of natural gas, within the meaning of the rule.

Second, the costs must be beyond the direct control of management. The proposed EPB activities and expenses are not required by any currently applicable environmental law. Therefore, all of the proposed activities and expenses are completely within the control of management. However, even if a current environmental law required the proposed activities, this is not "beyond the direct control of management" within the meaning of the rule any more than is compliance with any other statute that applies to utilities.

Third, the costs must be subject to sudden important change in level. Passage of new environmental statutes and regulations takes years, and even once passed, utilities are given time to meet the new requirements. Although costs to comply with environmental requirements continue to increase because those requirements become more stringent, the changes are not sudden. Therefore, environmental costs cannot be said to be subject to sudden important changes in level like volatile fuel costs. In addition, the EPB activities and costs MidAmerican is proposing are not required by any current environmental law. MidAmerican is to be commended for planning for future requirements, but it cannot be stated that the costs for what it is proposing are subject to sudden important changes in level within the meaning of the rule.

Fourth, the costs must be an important factor in determining the total cost to serve. Very little evidence regarding this factor was presented. MidAmerican presented no evidence regarding the total cost to serve, and Consumer Advocate presented only minimal evidence. (Tr. 189, 239). However, if the EPB budget for

only the two-year period ending April 1, 2004, is considered, the expenses MidAmerican will incur pursuant to the EPB are not an important factor in determining the total cost to serve. (Tr. 189, 239).

Finally, the costs must be readily, precisely, and continuously segregated in the accounts of the utility. MidAmerican stated it would comply with this requirement.

MidAmerican's argument that regulatory lag would prevent it from fully recovering EPB costs is not persuasive. After December 31, 2005, MidAmerican may file a rate case at any time it chooses. In addition, MidAmerican may recover its cost of money for the period of time the improvements are being constructed through an allowance for funds used during construction.

Since § 476.6(25) does not provide for the use of a tracker, and the use of a tracker for EPB activities and expenses is not consistent with prior uses of a tracker and the reasons for those prior uses, it would be inappropriate to allow use of a tracker for EPB expenses. MidAmerican's request for one is denied.

Since a tracker is not approved, there is no need to file an annual reconciliation, the statute does not provide for such a process, and MidAmerican should not file one.

V. Whether approval of MidAmerican's proposed emissions budget also means approval of MidAmerican's expenditures.

Paragraph 476.6(25)(c) states that the Board shall review the proposed plan and associated budget and approve it if it meets the requirements of the statute.

Paragraph 476.6(25)(e) states that the reasonable costs of preparing and litigating

the plan and budget, and the reasonable costs of implementing it, shall be included in the utility's regulated retail rates.

In its Application for Approval, MidAmerican requested the Board to state in its order approving the EPB, that if MidAmerican incurs the expenditures in the amounts and at the times called for in the EPB, they will be considered reasonable expenditures in accordance with § 476.6(25)(e), and subject to recovery via the cost recovery methods approved by the Board in this proceeding. (Application for Approval, pp. 6-7). MidAmerican made the same request in its Initial Brief, and also requested the Board to state that the plan investments would not be subject to Board reasonableness review in the future. (MidAmerican Initial Brief, pp. 4, 15-16, 24-25).

In its Initial Brief, MidAmerican stated that the Consumer Advocate suggested in cross-examination that § 476.6(25) calls for two separate determinations of reasonableness of EPB costs: when the plan is reviewed in this proceeding, and again when MidAmerican proposes to include the reasonable costs of preparing, filing, and implementing the plan in its rates. (MidAmerican Initial Brief, p. 15; Tr. 157-166, 169-179, 224). MidAmerican argues that the Consumer Advocate's position ignores the statutory intent of the statute, is inconsistent with its express provisions, and should be rejected by the Board. (Id.)

MidAmerican argues that the Consumer Advocate's interpretation would render the present proceeding meaningless. (Id.) It argues that under that interpretation, the plan and update process would have no impact on subsequent rate recovery, and a later rate proceeding would ultimately determine whether a utility

would recover its EPB costs. (Id.) It argued that one primary indicator that the reasonableness determination is to be made through the EPB process is the lack of a statutory requirement in § 476.6(25)(e) for DNR participation in a later proceeding. (Id.) It argues that under the Consumer Advocate's position, the Board could disallow reasonable EPB costs in a rate case that had previously been approved by the Board "and DNR"⁶ in the EPB proceeding. (Id.) MidAmerican further argued that unlike energy efficiency investments, emission construction investment projects have more predictable costs and results, and costs can be predicted within a certain margin of accuracy based on other projects and experience. (MidAmerican Initial Brief, p. 16). It argues that the certainty of cost recovery contemplated by the statute will be seriously affected if utilities are unable to obtain assurances of rate recovery for their EPB investments, that the Consumer Advocate's position would entirely nullify the EPB process, and should be rejected. (Id.) MidAmerican argues that once the Board makes the determination of reasonableness in the EPB proceeding, it should control the subsequent determination of reasonable costs that are to be included in retail rates. (MidAmerican Initial Brief, p. 25). MidAmerican stated that the duty of the Board in the rate proceeding would be to determine whether the cost that is proposed to be included in rates follows from the approved EPB investments. (Id.) In the rate case, if a proposed cost were consistent with the EPB, the Board would be obligated to continue to consider it a reasonable investment. (Id.)

⁶ The DNR does not approve costs in the EPB proceeding. Iowa Code Supp. § 476.6(25).

MidAmerican argues that any other result would essentially nullify the impact of plan approval on the recovery of costs of the investment. (Id.)

In its Initial Brief, the Consumer Advocate argued that MidAmerican's tracker proposal should not be allowed, and that costs incurred in implementing the approved EPB should only be recovered in base electric rates established after full review in a rate proceeding, and then, only to the extent that such costs are determined by the Board to be reasonable. (Consumer Advocate Initial Brief, p. 1). The Consumer Advocate argues that this is required by paragraph 476.6(25)(e), which states that the reasonable costs incurred by the utility in preparing and filing the EPB and in participating in the proceedings, and the reasonable costs associated with implementing the EPB shall be included in its regulated retail rates. (Id.) The Consumer Advocate argues that only full review in a rate case can provide the Board the statutorily mandated opportunity to determine the reasonableness of the costs incurred by MidAmerican in implementing the Board approved EPB. (Id.) The Consumer Advocate argues that MidAmerican proposed no reasonableness review of incurred costs, and this position contravenes the statute. (Consumer Advocate Initial Brief, p. 2). The Consumer Advocate argues that EPB costs are not significantly different from other investments and expenses of the utility, that these investments and expenses have always been reviewed by the Board for reasonableness in a rate case, and that only reasonable costs have been allowed in base electric rates. (Id.) The Consumer Advocate argues that EPB costs should continue to be reviewed for reasonableness in a rate case, and only the reasonable

costs should be allowed by the Board to be included in base rates charged to MidAmerican's electric customers. (Id.) The Consumer Advocate further argued that the Board must adopt a process to affirmatively determine the reasonableness of incurred emissions costs before such costs may be recovered from customers to comply with paragraph 476.6(25)(e). (Consumer Advocate Initial Brief, p.12).

The Consumer Advocate argues that MidAmerican's contention that Board approval of MidAmerican's emissions budget constitutes Board approval of MidAmerican's incurred emissions costs is legally and factually untenable. (Consumer Advocate Reply Brief, p. 1). It argues that MidAmerican's position ignores Iowa Code § 476.6(25), which explicitly requires two separate and distinct Board approvals: 1) the reasonable emissions budget in paragraph 476.6(25)(c), and 2) the reasonable incurred emissions costs in paragraph 476.6(25)(e). (Consumer Advocate Reply Brief, p. 2). The Consumer Advocate further argues that MidAmerican also ignores MidAmerican witness Mr. Schaefer's acknowledgements that planning a budget is entirely different from incurring a cost, and that there are distinct gradations of reasonableness, unreasonableness, prudence, and imprudence with respect to an actually incurred cost. (Id.)

The Consumer Advocate's argument that paragraphs 476.6(25)(c) and (e) require two separate reasonableness reviews would gut the purpose of the statute: to provide utilities with a determination that proposed expenditures are reasonable and in conformance with the statutory requirements before the amounts are actually spent. The fact that paragraph (c) requires the Board to determine whether the

proposed budget reasonably meets the statutory requirements, and paragraph (e) requires that reasonable costs shall be included in retail rates, does not mean that two separate determinations of reasonableness are required. Approval by the Board of the plan in the EPB process means the Board has determined that the budget reasonably meets the statutory requirements. Iowa Code paragraphs 476.6(25)(b) and (c). The use of the term "reasonable costs" in paragraph 476.6(25)(e) means that only the reasonable amounts actually spent pursuant to the approved EPB may be included in regulated retail rates. That is, the utility may not include the approved budgetary amounts in its regulated retail rates, but only the amounts actually spent pursuant to the approved budget. Therefore, once MidAmerican has received approval of an EPB, it must only prove to the Board in a subsequent rate proceeding that the costs it incurred in implementing the EPB were in accordance with the approved EPB. The amounts spent must be for the proposed activities, for no greater than the budgeted amounts contained in the EPB, and within the timeframes proposed in the EPB. If MidAmerican's expenditures are not in accordance with the approved EPB, MidAmerican may still seek regular, after-the-fact approval just as for any non-EPB costs. Those expenditures would be subject to full reasonableness and prudence review, including a review for compliance with the paragraph 476.6(25)(c) requirements. In addition, MidAmerican has not presented its costs for preparing and filing its EPB, and for participating in this proceeding, because these costs will not be known until the conclusion of this proceeding. No determination of reasonableness regarding those costs has been made in this case. Therefore,

MidAmerican may present such costs in its rate case and they would be subject to a reasonableness review at that time pursuant to paragraph 476.6(25)(e).

VI. Whether MidAmerican's proposal for a 10 percent contingency factor should be approved.

In its Application for Approval, MidAmerican proposes that it file a reconciliation of actual and planned EPB costs by February 15 of each year following plan approval, and if actual annual costs incurred are not more than 110 percent of the planned amount, it would not be required to demonstrate the reasonableness of the variance unless so ordered by the Board. (Application for Approval, p. 4). MidAmerican also proposed that if actual annual costs exceeded 110 percent, it would file a plan update demonstrating the reasonableness of the amount exceeding 110 percent. (Id.)

MidAmerican argues that its proposed process will avoid unnecessary minor plan update filings. (MidAmerican Initial Brief, p. 9; Reply Brief, p. 7). It argues that it is reasonable to expect that expenditures will be different from costs estimated up to two years in advance on projects costing at least hundreds of thousands of dollars. (Id.) It argues that costs may vary from year to year because of unknown obstacles or rescheduling of outages during which work would be performed, so that work would be moved from one year to the next. (MidAmerican Initial Brief, p. 10; Tr. 55-58). It argues that since its cost estimates are as accurate as possible, it is unlikely that it would exceed its cost estimates by 10 per cent each year, and that it would refine cost estimates through its updates that must be filed at least every two

years. (MidAmerican Initial Brief, p. 10). MidAmerican acknowledges that Sargent and Lundy's cost calculations, on which MidAmerican's EPB is based, include a 10 per cent contingency for costs for unidentified design refinements for each investment. (Id.) MidAmerican argues that the label "contingency" is misleading, since the 10 percent amount is fully expected to be expended for each investment. (Id.) It argues that the label is used because the reason for the expenditure cannot be discerned until the expenditure is made, and that it does not address the situation in which expenditures spill from one year to the next. (Id.) It argues that the request for a 10 percent contingency factor is not duplicative. (Id.) MidAmerican argues that it will keep the Board and the parties fully informed through its annual reconciliation. (MidAmerican Initial Brief, p. 11). MidAmerican argues that the 10 percent contingency factor strikes an appropriate balance between the Board's need to approve reasonable levels of expenses and the utility's need for a margin in predicting costs to be incurred in the future. (MidAmerican Initial Brief, p. 27). MidAmerican argues that there is nothing in § 476.6(25) that prevents the Board from establishing a range of reasonableness in this proceeding, and the Board should deem 10 percent above the approved plan budget as reasonable. (Tr. 57; MidAmerican Reply Brief, p. 7). It argues that the Consumer Advocate's argument does not consider the substantial amount of scheduled Board oversight that exists and MidAmerican's ability to make credible estimates so there will not be cost overruns. (MidAmerican Reply Brief, pp. 7-8). MidAmerican further argues that the legislature enacted the statute to provide a level of certainty for utilities seeking to

invest in emissions control equipment, and if MidAmerican is denied its proposal, it may have to incur expenditures without guarantee of recovery, or delay installation of equipment, which is contrary to the statute's intent. (MidAmerican Reply Brief, p. 8).

The Consumer Advocate argues that the Board should reject MidAmerican's proposal for a 10 per cent contingency. (Tr. 231; Consumer Advocate Initial Brief, p. 4). It argues that MidAmerican's proposal would effectively eliminate a prudence and reasonableness review of either budgeted or incurred costs in excess of up to 110 percent of the Board approved EPB budgets. (Id.) It further argues that MidAmerican has estimated that approximately \$546.6 million, exclusive of the proposed Council Bluffs coal plant, will be spent over the nine year period 2002-2010, and that this means MidAmerican could potentially spend \$54.66 million without any Board review of the reasonableness of the expenditures either before or after they are made. (Tr. 231; Consumer Advocate Initial Brief, p. 5). It argues that EPBs must be filed every two years, and MidAmerican should be able to satisfactorily estimate expenditures within that timeframe. (Id.) It also argues that the amount and timing of emissions expenditures are well within MidAmerican's control, and if circumstances change dramatically, MidAmerican could immediately file a plan update. (Id.) Finally, the Consumer Advocate argues that if there is only one technology that is over the budget, that one technology could have an increase of 500 or 1000 percent and still be within the 110 percent of budget proposal. (Tr. 86-87; Consumer Advocate Reply Brief, p. 1)

MidAmerican's proposal is unreasonable and is unsupported in the statute. The statutory scheme is that MidAmerican must file sufficient proof that its proposed activities and budget meet the statutory requirements and are reasonable, and if it presents adequate proof, the Board approves the budget as reasonable. Paragraphs 476.6(25)(a), (b), (c), and (e). MidAmerican receives the assurance, prior to the time it spends any money, that if it follows the approved EPB, it may recover its reasonable costs in regulated retail rates. The statute does not say that MidAmerican may recover an amount deemed reasonable plus another 10 percent. If something drastic changes within the two-year period of the EPB, MidAmerican may file a plan update at any time. In addition, if MidAmerican has gone over its budgeted amount, or if the timing of an expenditure has changed slightly, there is nothing that precludes it from requesting after-the-fact approval for the overage or the change in timing in the subsequent rate case.

In addition, with respect to this particular EPB, MidAmerican is only proposing to install neural networks, has installed a neural network in one plant and thus has experience with actual costs, and has received proposals from vendors for installation of the remaining neural networks. Part of the basis of the approval of the plan budget was that MidAmerican had reasonably estimated the proposed costs. There is no reason to believe that actual expenditures will be over the budgeted amounts contained in the EPB.

VII. Whether MidAmerican's proposals regarding substitute technology should be approved.

In its Application for Approval, MidAmerican proposed that if it finds that it can achieve the same level of emissions reductions using the same or a different control method at a cost that is equal or lower than the total cost reflected in the plan, it should not have to make any further demonstration of reasonableness unless ordered by the Board. (Application for Approval p. 4; MidAmerican Initial Brief, p. 7). MidAmerican states this approach would give it flexibility to make common sense changes quickly. (MidAmerican Initial Brief, p. 7).

MidAmerican argues that this proposal is in conformance with the statutory directive to approve plans and updates if they are reasonably expected to achieve cost-effective compliance with applicable environmental requirements. (Id.) It argues that if the original equipment was deemed cost-effective for a certain level of emissions, then the substitute technology must logically be cost-effective when it achieves the same or a better level of emissions. (Id.) It further argues that when one technology is deemed reasonable by the Board, a less expensive and better technology will be reasonable as well. (MidAmerican Reply Brief, p. 8).

MidAmerican argues that this proposal is cost-effective because it allows MidAmerican to achieve immediate savings when a contractor proposes a new and better technology, which may come more often than the two-year plan cycle. (MidAmerican Initial Brief, p. 8). It argues that although it could file a plan update, it is illogical to require such updates when the process could delay installation, and

thus the benefits of the better, less expensive, technology. (Id.) MidAmerican disagrees with the Consumer Advocate's concern that substituted technology could adversely affect other emissions equipment at the same or other plants, and stated that any impact on the service life of equipment would be taken into account in estimating whether the substitute technology is less expensive. (MidAmerican Initial Brief, pp. 8-9; MidAmerican Reply Brief, p. 9). MidAmerican noted in its brief that DNR witness Mr. Phelps testified that substitution of technology may adversely impact emissions of other pollutants. (Id.) MidAmerican argued that there is no evidence that DNR's role in this process would be constrained by the substitution of technology, or that the statute takes away DNR's authority to issue air construction permits. (Id.)

In the alternative, if the Board rejects MidAmerican's substitution proposal, MidAmerican urged approval of the alternate, expedited approval process testified to by Mr. Whitney. (MidAmerican Initial Brief, p. 9; MidAmerican Reply Brief, p. 10). Witness Mr. Whitney proposed that the Board approve plan updates for substituted technology within 30 days after filing if no objections are made during the first 20 days of that period, and that if an objection is filed, the Board require a final resolution be filed with the Board within 90 days. (Tr. 82-83, 87-91; MidAmerican Initial Brief, p. 9). In its Initial Brief, MidAmerican modified the description of the process from that testified to by Mr. Whitney, and stated that if an objection were filed, the Board should make a final approval determination within 90 days. (MidAmerican Initial Brief, p. 9). It later described the process as being that if there

were an objection, an effort would be made to obtain resolution within 90 days, and if this did not work, the Board could set the matter for hearing. (MidAmerican Initial Brief, p. 22). It also stated that if resolution could not be reached in 90 days, the substitution proposal could be withdrawn. (Id.)

At the hearing, Mr. Whitney testified that for the two-year period covered in this EPB, it is possible but highly unlikely that MidAmerican would need to substitute control technologies. (Tr. 89-90). MidAmerican argues that a decision on the issue should still be made at this time, because no valid reason has been cited by any party for a delay on the decision, and substitution could occur at any time. (MidAmerican Initial Brief, p. 21). It argues that resolution will provide certainty as MidAmerican prepares its next filing. (Id.)

MidAmerican argues that the Board has the authority to approve the substitute process proposed by Mr. Whitney. (MidAmerican Initial Brief, p. 21-22). It acknowledges that subparagraph 476.6(25)(a)(3) requires that plan updates be considered in a contested case proceeding. (MidAmerican Initial Brief, p. 22). However, MidAmerican argues, while certain procedural requirements apply to contested cases that are not required of other agency action, the Board could exercise its broad general powers pursuant to § 476.2(1) to effect its § 476.6(25) authority in a way that was compatible with Iowa Code Chapter 17A contested case requirements and the policy of House File 577. (MidAmerican Initial Brief, p. 22).

For example, MidAmerican believes the following notice procedure would comply with contested case requirements. (Id.) Since § 17A.12 requires that

commencement of a contested case proceeding must be preceded by notice to parties apprising them of their rights to a hearing, the Board could by rule prescribe a form of notice to be delivered to all parties to a utility's most recent plan proceeding at or before the time of a plan update filing. (Id.) The notice would state the Board's intention to handle the EPB update as MidAmerican proposed, that is, to receive comments for 20 days from the date of filing and to resolve the matter within 30 days of filing without a hearing if there are no factual or legal arguments raised in objection; alternatively to have the parties resolve the matter within 90 days by negotiation if there are factual disputes, and to set the matter for hearing if disputes remain after the negotiation period. (Id.) MidAmerican argues that as long as these contested case notice requirements are complied with and the matter may be resolved by hearing, the Board would be in compliance with contested case requirements. (MidAmerican Initial Brief, pp. 22-23).

Alternatively, MidAmerican argues the Board could recognize the potential for substitution as part of a range of updates in its decision in a plan proceeding, which would minimize the need for plan update contested case proceedings. (MidAmerican Initial Brief, p. 23). MidAmerican argues that the Board may interpret its enabling legislation in either a contested case or through rulemaking, but acknowledged that the Board may wish to initiate a rulemaking proceeding for the purpose of future application. (Id.) It stated that if Mr. Whitney's alternative is adopted, the Board would need to employ rulemaking procedures to implement it. (Id.) MidAmerican further argues that substitution of technologies should be permitted if it does not

result in increased costs to achieve the same results, and there is no reason to defer MidAmerican's substitution proposal to a later rulemaking. (MidAmerican Initial Brief, pp. 23-24).

The Consumer Advocate argues that MidAmerican's proposal to substitute technologies without Board approval should be rejected. (Consumer Advocate Initial Brief, p. 5). The Consumer Advocate argues that MidAmerican must file plan updates at least every 24 months, and in such a short timeframe, there should not be the need for major changes in the type of equipment or technology installed. (Id.) It argues that if MidAmerican unilaterally substituted equipment or technology from that approved by the Board, the substitution could adversely affect other aspects of the EPB. (Consumer Advocate Initial Brief, p. 6). It argues that DNR witness Mr. Phelps fully agreed. (Id.; Tr. 280-282).

The Consumer Advocate argues that MidAmerican prepares its EPB on a comprehensive and integrated basis, that each component is designed to work in conjunction with each other component, and the totality of investments and expenditures are designed to achieve specific emissions results. (Consumer Advocate Initial Brief, p. 6). It argues that if a substitution is made, it may have an adverse impact such as reducing another component's effectiveness or efficiency in achieving emissions results. (Id.) It argues the substituted technology may have a shorter or less effective or efficient service life, or may cause another component to have a shorter or less effective or efficient service life. (Id.) It argues that MidAmerican can readily bring any proposed change in technology to the Board for

approval in plan updates. (Id.) That would allow the Consumer Advocate, DNR, other interested parties, and the Board the opportunity to evaluate whether the proposed change in technology is as effective and efficient as that originally proposed, is of equal or lesser cost, and has any adverse impact on other components. (Consumer Advocate Initial Brief, pp. 6-7).

The Consumer Advocate states that Mr. Whitney's proposed process is generally acceptable at this time in this proceeding. (Consumer Advocate Initial Brief, p. 10). It further argues that no rulemaking is necessary, and that the proposed process allows the Consumer Advocate, DNR, and the Board to carry out their respective statutory duties. (Id.)

DNR argues that there is no reason to decide the substitution question at this time, since MidAmerican witness Mr. Whitney testified the need for substitution is more likely in the future than in this two-year period. (DNR Reply Brief, pp. 2-3; Tr. 90) DNR argues that it would be advisable to wait until a complete cycle of the EPB process has occurred to determine whether this type of summary proceeding is necessary in addition to the processes already mandated by the statute. (DNR Reply Brief, p. 3). DNR further argues that the Board does not have the authority to approve Mr. Whitney's substitution process, because DNR has the statutory obligation to participate as a party in contested case proceedings involving the EPB and any subsequent updates. (Id.) DNR acknowledges that MidAmerican would still need to apply for permits for substitute equipment. (Id.) However, it argues that use of the summary process proposed by MidAmerican would constitute an update to the

plan, but would not allow DNR or other parties to participate in the required contested case proceeding. (Id.) DNR argues the proposal is not compatible with the Iowa administrative procedure act or the spirit of § 476.6(25). (Id.)

DNR further argues that a rulemaking or formal ruling of the Board would be necessary to make it clear that DNR should be notified promptly of MidAmerican's intent to make substitutions, so that DNR could make an attempt, as a party, to object if necessary. (DNR Reply Brief, pp. 3-4). DNR suggests that if the Board accepts the proposal, that MidAmerican be directed to FAX its summary updates to DNR, so that DNR might have the best chance to respond in the short time allowed. (Id.) However, DNR argues that the Board should not adopt such a procedure. (Id.)

In its Supplemental Reply Brief, MidAmerican argues that the Board should rule on the substitution question now. (Supplemental Reply Brief, p. 1). MidAmerican argues that DNR's position presumes that MidAmerican will install the neural networks as planned, and that it will not make other environmental emission investments until April 1, 2004. (Id.) MidAmerican argues that although this is a possible outcome, it is not a guaranteed one. (Id.) It argues that because updates may be filed at any time, it is appropriate to rule on substitution now. (Id.) It argues that if a cancellation or substitution of the neural networks is needed during this plan cycle, there could be some urgency associated with the change. (Supplemental Reply Brief, p. 2). These might be that prices and availability of substitute equipment could be guaranteed for a short time, or specialized labor may only be available in a certain window of time. (Id.) MidAmerican argues the Board should rule on this

issue now to ensure that there is no unwarranted delay because of the need to file updates. (Id.) MidAmerican further argues that DNR will have the opportunity to participate in any plan update if MidAmerican's alternative plan update process is approved. (Id.) MidAmerican argues that if the alternative process is approved, a plan update would be filed, reviewed by interested persons and could be approved in either 30 days if there were no objections, or 90 days, if negotiation between the parties was needed. (Id.) If the update was not resolved during the 90-day period, MidAmerican could either seek approval through an evidentiary hearing or withdraw the proposal. (Id.) MidAmerican argues that DNR is a necessary party to all plan update proceedings, and it is not MidAmerican's intent to deny DNR, or any other interested person, the ability to participate in any proceedings that consider environmental emissions expenditures. (Supplemental Reply Brief, pp. 2-3).

MidAmerican argues its proposed process is intended to comply with the administrative procedure act and § 476.6(25), and at the same time, provide utilities with rapid guidance regarding whether a proposed investment is considered reasonable by all parties, is negotiable, or whether it is so objectionable to some persons that the only way to secure a determination of reasonableness is via a full-blown evidentiary hearing. (Supplemental Reply Brief, p. 3). MidAmerican argues that the process preserves all parties' due process rights, while at the same time, allowing the utility to know quickly whether a proposal was acceptable, negotiable, or generally unacceptable to parties. (Id.)

MidAmerican also argues that its original or alternative substitution proposals are within the authority of the Board and involve DNR. (Supplemental Reply Brief, p. 4) It argues that if the Board approves the original substitution proposal, "its approval of a plan or update will effectively deem a range of activities to be reasonable – the plan actions, as well as substitutions that result in the same level of emission reductions at a lower cost." (Id.) It argues that DNR will be involved in all plan and update contested case proceedings and that MidAmerican is willing to inform DNR when it makes a substitution, if DNR would like notice in addition to the annual reconciliation filings that have been proposed. (Id.) Finally, MidAmerican argues, any substitution may require a DNR permit, subjecting the investment to another kind of reasonableness review. (Id.)

The problem with MidAmerican's original and alternate substitution proposals is that they cannot be reconciled with § 476.6(25). When it changes what was approved in an EPB by substituting technology, MidAmerican is updating its EPB. The statute explicitly provides the procedure to be used for EPB updates. Section 476.6(25) requires, among other things, that the initial EPB and any subsequent updates be filed with the Board and served on the DNR, considered in a chapter 17A contested case proceeding, in which DNR and the Consumer Advocate are necessary parties, and in which, DNR must state whether the plan or update meets applicable environmental requirements, and must recommend amendments if it does not. Paragraph 476.6(25)(a). The statute further prohibits the Board from approving a plan or update that does not meet applicable environmental standards, in which it

necessarily relies on DNR's review of the plan or update and its opinion regarding compliance. Paragraph 476.6(25)(b). It further requires the Board to make its own independent determination of whether the plan or update and associated budget are reasonably expected to achieve cost-effective compliance with applicable environmental requirements, and in reaching its decision, the Board must consider whether the plan or update and the associated budget reasonably balance costs, environmental requirements, economic development potential, and the reliability of the electric generation and transmission system. Paragraph 476.6(25)(c). The review by the Board must be done whether or not any party objects to MidAmerican's proposal. DNR and the Board review a plan or update and the associated budget with the particular activities and budget proposed by MidAmerican. The DNR's findings, and the Board's approval based on those findings, depend on the particular details of the plan or update and budget as proposed by MidAmerican.

If MidAmerican unilaterally makes changes to the plan or update and associated budget, the changes have not been reviewed by DNR or the Board as required. DNR and the Board have not been provided with the changes as required. They have no opportunity to perform their statutorily required duties with respect to the changed plan. As Mr. Phelps testified, there may be cases where the substitution of one technology for another while maintaining the emission reduction of the primary pollutant at one level may cause increased levels of another pollutant emitted by the same process. (Tr. 281). For example, Mr. Phelps testified that installing low NOx burners frequently causes higher carbon monoxide emissions. (Tr. 282). This

testimony was not contested. Although Mr. Phelps stressed this is something that may happen, rather than something that would necessarily happen, unilateral substitution of technology by MidAmerican would not allow DNR to review the substituted technology to see if it caused a problem.

MidAmerican's argument that DNR may still be allowed to review the substituted equipment in the air construction permit application process is not persuasive. In the first place, MidAmerican may not be required to apply for an air construction permit. In the second place, such review would not be within the § 476.6(25) process as required. When DNR cannot perform its statutory function, the Board does not have the expert opinion on which its own review depends, and cannot perform its own required statutory functions. Paragraphs 476.6(25)(b) and (c).

MidAmerican states that if its original substitution proposal is accepted, the Board's approval of a plan or update will effectively deem a range of activities to be reasonable – the plan actions, as well as substitutions that result in the same level of emission reductions at a lower cost. (Supplemental Reply Brief, p. 4). This is not reasonable, is not what is required by § 476.6(25), and it will not be approved.

MidAmerican's alternative substitution proposal also cannot be reconciled with a number of requirements in § 476.6(25). One of them is the requirement that a plan and budget and subsequent updates shall be considered in a chapter 17A contested case proceeding in paragraph 476.6(25)(a)(3). The notice issues, as acknowledged by MidAmerican in its briefs, are only one of the concerns. The procedure as

proposed by MidAmerican does not appear to provide sufficient time for DNR to perform its required review, particularly if a substitute technology of any complexity were proposed. In addition, the proposal ignores the fact that the Board must make an independent determination of reasonable compliance with the statutory requirements regardless of whether any party files an objection. It also ignores the fact that MidAmerican may not present sufficient evidence with its filing for DNR or the Board to be able to perform the required review, and additional information may need to be requested. If MidAmerican wishes quick review, it must present complete information necessary for the Board to be able to perform the review with its initial filing.

In addition to these issues, § 476.6(25) does not explicitly or implicitly provide for MidAmerican's procedure. Rather, it explicitly provides for a different procedure to be used with respect to plan updates. Therefore, in order for the Board to have the authority to approve an alternate expedited procedure, the requirements of the statute would have to be met and reconciled with the alternate procedure. The alternate substitution procedure proposed by MidAmerican cannot be reconciled with the statute and is therefore not approved.

It must also be remembered that MidAmerican is not prohibited from substituting technology at any time it believes substitution to be appropriate. Approval of the EPB technology only means that MidAmerican has advance assurance that it will be considered to be reasonable and the reasonable costs may

be included in retail rates. If MidAmerican needs to substitute technology, it may do so at any time, and seek after-the-fact approval in a subsequent rate case.

However, providing for some kind of expedited procedure for appropriate cases when there are limited changes to an approved EPB appears to be a worthwhile idea in a general sense. It seems possible that the 17A contested case requirements, the § 476.6(25) requirements, the needs of the other parties and the Board, and the needs of MidAmerican for expedited review of substitute technologies could be reconciled, if the issues were carefully thought through and addressed in a rulemaking proceeding. One advantage of a rulemaking proceeding is that ex parte rules do not apply, and the current parties, any other interested parties, and Board staff could speak to each other openly regarding the issues. If MidAmerican wishes to explore its proposal more fully, it may file a petition for rulemaking with the Board.

FINDINGS OF FACT

1. MidAmerican filed an emissions plan and budget with the Board pursuant to Iowa Code Supp. § 476.6(25) on April 1, 2002. It requests approval only for the activities and budget for the time period April 1, 2002, through March 31, 2004.

2. In the two-year period ending March 31, 2004, MidAmerican proposes to install neural networks at most of its Iowa coal-fired plants. A neural network is a system of computer hardware and software, sensors, and monitors tied into the plant's control system. It is designed to adapt to plant changes and improve plant

efficiencies, so that less coal is burned for each megawatt of energy generated and emissions are reduced.

3. MidAmerican and IPL are joint owners of the Ottumwa generating plant, and IPL operates the plant. In this EPB, MidAmerican also included certain activities and equipment to be implemented by IPL at the Ottumwa plant.

4. In this EPB, MidAmerican requests approval only for the installation of the neural networks and the work to be done by IPL at the Ottumwa plant, and for the associated budgets.

5. The proposed activities and budget for the Ottumwa plant were approved in In re: Interstate Power and Light Company, Docket No. EPB-02-150. Since MidAmerican requests approval of the identical activities and budget in this case, they are therefore approved for the same reasons given in the decision in Docket No. EPB-02-150.

6. The EPB meets applicable state environmental requirements and federal ambient air quality standards for regulated emissions from the MidAmerican coal-fired electric generating facilities at issue in this case.

7. There is no current state or federal environmental law that requires any of the actions proposed in the EPB. In the EPB, MidAmerican proposes to take actions to reduce emissions that it expects will be required in the future.

8. Based on the record, as of the date of this proposed decision, it is reasonable to assume that significant additional air emission reductions will be required from the plants at issue in this case, and that reductions of emissions in the

range of the levels and during the timeframes predicted by MidAmerican will be required.

9. Assuming the parties are correct that significantly more stringent environmental requirements, including significant SO₂, NO_x, and mercury emissions reductions will be required from the generating plants at issue in this case, within the timeframes predicted by MidAmerican, MidAmerican has presented sufficient, uncontroverted evidence to prove that its phased approach and the installation of neural networks proposed in the EPB for the two-year period ending March 31, 2004, are reasonable.

10. MidAmerican has presented sufficient, uncontroverted evidence to prove the amended budgeted amounts for installation of the neural networks, contained in Late-filed Exhibit 1, for the two-year period ending March 31, 2004, are reasonably expected to assist in achieving cost-effective compliance with future environmental requirements and are reasonable. The proposed budget for the Ottumwa plant is approved for the reasons given in the decision in In re: Interstate Power and Light Company, Docket No. EPB-02-150. The budget that is approved for the Ottumwa plant is that contained in Late-filed Exhibit 9 (as amended January 15, 2003) filed in Docket No. EPB-02-150, for the two-year period ending March 31, 2004.

11. MidAmerican has presented sufficient, uncontroverted evidence to prove that the plan and associated budget are reasonably expected to assist in the achievement of cost-effective compliance with future state environmental

requirements and federal ambient air quality standards that will be imposed on the Iowa plants at issue in this case within the time periods predicted by MidAmerican. It has presented sufficient, uncontroverted evidence to prove the plan and budget reasonably balance costs, environmental requirements (current and future), economic development potential, and the reliability of the electric generation and transmission system.

12. The emissions plan and budgeted amounts are therefore approved. Approval of the budget is not approval of a gross amount for all activities at all plants. Rather, for all plants other than the Ottumwa plant, it is approval of the plant-specific, activity-specific budget for the MEC share amounts contained in Late-filed Exhibit 1, for the period ending March 31, 2004, and for the Ottumwa plant, it is approval of the amounts contained in Late-filed Exhibit 9 (as amended January 15, 2003) filed in Docket No. EPB-02-150, for the period ending March 31, 2004.

13. Since § 476.6(25) does not provide for the use of a tracker, and the use of a tracker for EPB activities and expenses is not consistent with prior uses of a tracker and the reasons for those prior uses, it is inappropriate to allow use of a tracker for EPB expenses. MidAmerican's request for the EPB tracker should be denied. Since a tracker is not approved, there is no need to file an annual reconciliation, the statute does not provide for such a process, and MidAmerican should not file one.

14. MidAmerican's proposal for a 10 percent contingency factor should be denied.

15. MidAmerican's original and alternate proposals regarding substitute technology should be denied.

CONCLUSIONS OF LAW

1. The DNR must state whether the EPB meets applicable state environmental requirements for regulated emissions, and the Board may not approve the EPB if it does not meet applicable state environmental requirements and federal ambient air quality standards for regulated emissions. Iowa Code Supp. § 476.6(25)(a)(4) and (b). The difference between "applicable state environmental requirements" in paragraph 476.6(25)(a)(4), and "applicable state environmental requirements and federal ambient air quality standards" in paragraph 476.6(25)(b), is not significant, because DNR has been delegated responsibility for implementing a program sufficient to protect against a violation of the federal ambient air quality standards, and has incorporated those standards into its State Implementation Plan. In effect, for the purposes of interpreting section 476.6(25), the federal ambient air quality standards are applicable state environmental requirements.

2. The statute clearly contemplates that utilities will address currently regulated emissions and currently applicable environmental requirements in their EPBs. Paragraphs 476.6(25)(a), (a)(4), (b), and (c).

3. The Board shall approve the EPB if it is "reasonably expected to achieve cost-effective compliance with applicable state environmental requirements and federal ambient air quality standards." Iowa Code Supp. § 476.6(25)(c). The

board "may limit investments or expenditures that are proposed to be undertaken prior to the time that the environmental benefit to be produced by the investment or expenditure would be required by state or federal law." Iowa Code Supp.

§ 476.6(25)(f). The Board could refuse to approve the proposed EPB expenditures because they are not required by currently applicable environmental law. However, the Board is not required to do so, because paragraph 476.5(25)(f) is permissive, not mandatory. The purpose of the statute is to provide advance assurance to utilities that they will be able to include approved reasonable EPB costs in their regulated retail rates. Iowa Code Supp. § 476.6(25)(e). Approval of proposed actions and budgets prior to the time they are required by applicable environmental law is not necessarily incompatible with the language and purpose of the statute.

4. The statute provides no explicit criteria or guidance as to whether or when the Board should limit proposed expenditures pursuant to paragraph 476.6(25)(f). However, the statute contains such criteria to be used by the Board when it evaluates a plan and budget with respect to currently applicable environmental requirements. Iowa Code Supp. § 476.6(25)(c) and (e). It is reasonable to use this language as guidance when evaluating proposed activities and expenditures that will be undertaken prior to the time they are required.

5. Paragraph 476.6(25)(c) provides that the Board shall approve the plan and budget if they are "reasonably expected to achieve cost-effective compliance" with applicable requirements. "In reaching its decision, the board shall consider whether the plan or update and the associated budget reasonably balance costs,

environmental requirements, economic development potential, and the reliability of the electric generation and transmission system." Iowa Code Supp. § 476.6(25)(c). Iowa Code Supp. § 476.6(25)(e) provides that the "reasonable costs" incurred for preparing, filing, and participating in Board proceedings, and the "reasonable costs" of implementing the plan, shall be included in regulated retail rates. This paragraph provides further support that the budget is to be reviewed for reasonableness under paragraph 476.6(25)(c).

6. Although MidAmerican's plan and budget is approved, only actual expenditures made pursuant to the plan and budget may be included in retail rates. Iowa Code Supp. § 476.6(25)(c) and (e).

7. The Consumer Advocate's argument that paragraphs 476.6(25)(c) and (e) require two separate reasonableness reviews would gut the purpose of the statute: to provide utilities with a determination that proposed expenditures are reasonable and in conformance with the statutory requirements before the amounts are actually spent. The fact that paragraph 476.6(25)(c) requires the Board to determine whether the proposed budget reasonably meets the statutory requirements, and paragraph 476.6(25)(e) requires that reasonable costs shall be included in retail rates, does not mean that two separate determinations of reasonableness are required. Approval by the Board of the plan in the EPB process means the Board has determined that the budget reasonably meets the statutory requirements. Iowa Code paragraphs 476.6(25)(b) and (c). The use of the term "reasonable costs" in paragraph 476.6(25)(e) means that only the reasonable

amounts actually spent pursuant to the approved EPB may be included in regulated retail rates. That is, the utility may not include the approved budgetary amounts in its regulated retail rates, but only the amounts actually spent pursuant to the approved budget. Therefore, once MidAmerican has received approval of an EPB, it must only prove to the Board in a subsequent rate proceeding that the costs it incurred in implementing the EPB were in accordance with the approved EPB. The amounts spent must be for the approved activities, for no greater than the approved budgeted amounts contained in the EPB, and within the timeframes proposed in the EPB. If MidAmerican's expenditures are not in accordance with the approved EPB, MidAmerican may still seek regular, after-the-fact approval in the rate case just as for any non-EPB costs. Those expenditures would be subject to full reasonableness and prudence review, including a review for compliance with the paragraph 476.6(25)(c) requirements. In addition, MidAmerican has not presented its costs for preparing and filing its EPB, and for participating in this proceeding, because these costs will not be known until the conclusion of this proceeding. No determination of reasonableness regarding those costs has been made in this case. Therefore, MidAmerican may present such costs in its rate case, and they would be subject to a reasonableness review at that time pursuant to paragraph 476.6(25)(e).

IT IS THEREFORE ORDERED:

1. MidAmerican's Emissions Plan and Budget filed April 1, 2002, as amended and as discussed in this order, is approved. MidAmerican's proposals for a

tracker mechanism, a 10 percent contingency, and both substitute technology proposals are denied.

2. The Consumer Advocate's argument that two separate determinations of reasonableness must be made by the Board is rejected.

UTILITIES BOARD

/s/ Amy L. Christensen
Amy L. Christensen
Administrative Law Judge

ATTEST:

/s/ Sharon Mayer
Executive Secretary, Assistant to

Dated at Des Moines, Iowa, this 19th day of March, 2003.